

Economics primarily
concerned with
resources choices
economics essay



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Economics is primarily concerned with resource choices, but the various elements that effect the availability of these resources is also an important factor. Economics is the study of the means by which people gain their resources and how they use their resources. Decisions have to be made on which choices to allocate our resources on. These choices are dependent on our tastes, the possessions we already have, the time available to us, the money we have and the scarcity of the item/s we seek to acquire. Each factor is limited, meaning the resources available to us are limited and we cannot have all the items we desire. This requires us to make choices and thereby make sacrifices in making an overall decision.

For instance, Peter would like to purchase a gold watch, this watch is highly in demand, unlike the silver watch which is also available. The resources used to manufacture the gold watch are, however limited and therefore Peter has to wait for 2 weeks in order to purchase it, thereby sacrificing 2 weeks without a watch instead of buying the silver watch. He also wanted to purchase a new phone, but substituted it to acquire the gold watch.

The opportunity cost of acquiring the gold watch instead of the silver one is 2 weeks without a watch. The opportunity cost of deciding on purchasing a watch is a new phone.

i. The curve of GDP at 2004 is calculated by using old prices that do not include

inflation. It treats price as constant over time.

The curve of GDP at current market prices uses prices of the current year which include inflation prices. These prices are of the current production amounts.

The curve of current market prices provides a reflection that does not take inflation into consideration and therefore the large variation in prices that are the lowest and the highest in the graph. The curve of real values is adjusted for inflation, it provides a real representation of the prices. It is therefore less elastic in comparison to the nominal value curve.

ii. Highest GDP levels at current market prices: 2002, 2007, 2008

Lowest GDP levels at current market prices: 2004 - 2005

The level of GDP at current market prices was at its highest during the indicated times, because of economic growth, decrease in inflation and improvements in productivity. GDP decreased in the other time periods as the country went through a recession. This may have been caused the bursting of an economic bubble or supply shock which caused the decrease in national spending.

iii. Index value for Real GDP in 2007

2004 = base year

Index of GDP Nominal values

- 3.0%

+ 19.0%

16.0%

100.0

+ 19.0

119.0

2004 = 100

2007 = 119

16% = annual % 19 = % change in

Change in GDP from 2004

GDP in 2007 to 2007

Index of Real GDP Values

- 1.5%

+ 11.5%

10.0%

100.0

+ 11.5

111.5

2004 = 100

2007 = 111.5

11.5% = annual % 19 = % change in

Change in GDP from 2004

GDP in 2007 to 2007

Index of Real GDP in 2007

$119/111.5 \times 100 = 106.7$ Nominal value divided by Real value multiplied by
base year value = 106.7

iv. Real GDP Growth from 2001 to 2010

2001 = base year

YEAR	INDEX OF NOMINAL GDP	INDEX OF REAL GDP	INDEX OF REAL GDP GROWTH
2001	100.0	100.0	100.0
2002	100.5	100.5	100.0
2003	97.0	100.5	96.5
2004	85.0	91.5	92.9
2005	85.5	94.0	91.0
2006	98.0	101.5	96.6
2007	104.0	103.0	101.0

2008 101. 0 101. 5 99. 5

2009 99. 0 100. 5 98. 5

2010 96. 0 99. 0 97. 0

QUESTION 2

Income and Substitution Effects

The changes in price can affect buyers' purchasing decisions; this effect is called the income effect. Increases in price do not affect the amount of your salary, but they make you feel poorer than you were before, and you therefore buy less. Decreases in price make you feel richer, and therefore you may feel like buying more.

A restaurant may sell both hot dogs and hamburgers. If the price of hot dogs rises, but the price of hamburgers stays the same, one may be more inclined to purchase a hamburger. This inclination to adjust your purchase based on changes in comparative price is called the substitution effect. When the price of hot dogs rises, it makes hot dogs relatively expensive and hamburgers relatively cheap, which influences you to purchase a smaller amount of hot dogs and more hamburgers than you normally would. Similarly, a decline in hot dog prices would influence you to eat more hot dogs and fewer hamburgers, according to the substitution effect.

Buying decisions are also affected by the income effect when there are two or more goods. When the price of hot dogs goes up, it makes you feel

comparatively poorer, so one may be inclined to purchase fewer of both hot dogs and hamburgers.

Normal, Inferior, and Giffen Goods

If you buy more of a good when your income increases, that good is called a normal good. If you buy less of a good when your income increases that good is called an inferior good. For instance, John regularly buys apples and oranges. His income increases and he subsequently buys more apples and less oranges. The apples are the normal good and the oranges are the inferior good.

When one buys more of a good when the price of a good increases, it is called a Giffen good. This equates to an upward sloping demand curve. Such situations are not common, as increase in prices usually results in people buying less of the good. A reason for Giffen goods is that some people associate higher prices with quality, luxury and status. They believe that higher prices increase the perceived value of a product.

QUESTION 3

Oligopoly is a market form in which few relatively large firms are dominant.

The following characteristics define oligopoly:

Oligopolies determine the price of goods in the market. Products in this market form are uniform or differentiated. They maximize profits by producing where marginal revenue is equal to marginal costs. They have high barriers to entry the most significant barriers are patents, the access to expensive and intricate technology, economies of scale and the use of <https://assignbuster.com/economics-primarily-concerned-with-resources-choices-economics-essay/>

various strategic actions by established firms designed to eliminate emerging firms. The limited number of firms in this market form means that the activities of one firm can influence the activities of the other firms.

Oligopolies have perfect knowledge of the costs and demand functions of their own firm, but their knowledge of relevant firms is lacking. Buyers only have imperfect knowledge on the product cost, price and quality.

The distinguishing feature of an oligopoly is interdependence. The few large firms in oligopolies are so large that their individual actions affect market actions. The two elements in oligopolistic interdependence are that firms anticipate and react to the behaviour of rival firms. Each competing firm must therefore recognise that every decision they make will provoke a reaction by other firms and must be aware of repercussions resulting from that.

The two approaches that may be considered in dealing with interdependence in oligopoly are: Games theory and Kinked demand curve theory.

Kinked Demand Theory of Oligopoly

Oligopolistic firms may expect competing firms to replicate their price reductions, by reasoning that their rivals would not want to lose market share. Similarly the firm may also expect rival firms to maintain their prices when it raises its prices, reasoning that they would be happy to gain customers from the higher prices of the firm.

When the firm perceives that other firms will replicate its price reductions, then its facing demand curve will be inelastic for price reductions. In

increasing its prices it would not expect other firms to do the same; therefore its demand curve for price increases would be elastic. The demand curve will therefore have a kink, as illustrated at K in Figure 1. The rival's price is PR, the section below it is price inelastic and the one above it is price elastic. The marginal revenue curve that is related with this specific kinked demand curve would not be continuous with the gap in it (M1M2 in Figure 1).

FIGURE 1 Kinked demand

Source: CEM (2003)

One can assume that the oligopolist has the usual cost curves. In overlaying them on the revenue and demand curves, it is very likely that the MC curve will pass between the gap at MR (M1M2). This is illustrated in Figure 2.

FIGURE 2 Equilibrium in oligopoly

Source: CEM (2003)

This oligopolist is a profit maximiser, so they will try to ensure that marginal revenue equates to marginal cost. This case is irregular as there is no output at which MC and MR are equal. Higher outputs are able to generate less revenue than costs; therefore Q_e will be the best output, because outputs that are lower are able to generate more revenue than cost. P_e is the kink price (price that rivals are charging), the price for output Q_e . Due to the fact that oligopolistic firms are protected by barriers to entry, they are able to earn supernormal profit. This is illustrated by Figure 2.

Points to draw from the model are:

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Price competition will be limited. Oligopoly firms are likely to charge similar prices. In Figure 2 the rival firms prices (PR) are similar to our oligopolist's prices (PR).

Price stability will be prevalent. As costs shift, the firms may still maintain similar prices. The relevant output and price will remain unaffected if there is a shift of any kind involving MC between M1 and M2. There is also no theory of price determination.

The positive conclusions that are mentioned are supported by the proof of oligopoly actions in the real world. These specific firms are in favour of non-price competition by advertising aggressively, development, research and good after sales service and so forth. They do not participate in price wars. The distinctive feature of an oligopoly is price stickiness. When the prices change, it is mostly due to the consequence of price leadership. This is due to collusion or as a result of a firm's dominance.

Games Theory

In a two player game, the rows form the actions of the first player, and the columns form the actions of the second player. The various entries within the matrix represent the utility or payoff to both players. The following example is of the Prisoner's Dilemma game. The game features two players who partnered in committing a crime. They have been captured by the police and placed in separate cells. They are offered the opportunity to confess. This game is represented by the following matrix of payoffs

not confess confess

not confess 5, 5 -4, 10

confess 10,-4 1, 1

Source: David K. Levine (undated)

The higher numbers represent more utility. If none of the suspects confess, they will be set free and will share the proceeds from their crime. For each suspect this is represented as 5 units of utility. If none of the suspects confess, they will both be set free. If one prisoner testifies against the other and the other does not, the one who testified is set free and receives the full 10 units of utility. The prisoner who did not confess goes to jail and therefore has the -4 unit of utility. If both prisoners were to confess they would both be convicted, but with reduced terms and therefore giving each the 1 unit of utility.

The different strategies are based on the motives of prisoners, depending on whether they are looking out for themselves or for the good of both of them. This is similar to the game theoretic problems and public goods problem. For example, two competing firms in the same market may both set high prices for goods which would be best for both firms. However, it would be best for an individual firm if it set low prices and the opposition set high prices.

QUESTION 4

Land prices tend to fluctuate in a free market, because the markets are regulated by buyers and sellers. The market aims to maximize profits and do not look out for the general welfare of society. In a free market, prices of various goods may increase or decrease according to the demand of goods.
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This increase or decrease in demand affects the price of land, because land is the primary factor of production; it is used in all forms of production and its value is therefore easily influenced by the demand of external goods.

The government does not impose any tariffs or subsidies; the lack of market intervention and regulation by government enables the suppliers to set the highest prices for land. Land is scarce and cannot be increased, and thus further encourages the prices to be increased as demand is usually high when resources are limited. Overall these elements influence price: The limited regulations; the goals of the market to maximize profits; the scarcity of land which increases demand; and the external goods that require land for them to be produced. These elements along with freedom buyers and sellers have in regulating prices in the market, maximizes the potential for land prices to fluctuate in a free market.

Land is a natural resource and the primary factor of production. Its value is created by our need to use land for various purposes such as: mining, transport, education, housing, agriculture and for business activities. “Wikipedia (2011) states that Land Value Tax is a levy on the unimproved value of land. It is an ad valorem tax on land that disregards the value of buildings, personal property and other improvements.” Taxes on land are preferable to taxes on other factors for various reasons. Land Value Taxation is a reasonable way to pay for public services.

In comparison to taxes on buildings LVT offers a widespread tax base as it includes empty sites and empty properties. Land belongs to all the citizens of the country; however its scarcity does not allow each citizen to acquire it.

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The LVT is therefore a form of distributing income and reducing the gap between the rich and poor. This is possible, because the LVT encourages the use of empty sites which are targeted for development. These create job opportunities and wealth. This income distribution also occurs in compensation. For example: with a new railway line built, the value of land near the station would increase, but the value of land nearby the tracks would decrease as a result of the noise and vibration. This land would automatically pay lower LVT without any complicated appeals system.

Land Value Tax encourages investment in public services and shifts private investment from land speculation to productive enterprises. This often increases the value of land. The rise in the land value increases the wealth of consumers and increases aggregate demand. In contrast to its role in increasing land prices LVT also deters the escalation of land prices. This allows banks to lower interest rates, which benefits homeowners, industry and small firms.

Land Value Tax is cheaper to collect in comparison to other taxes such as: PAYE, NICS and VAT, and it does not demand collection costs from the businesses. With business tax and income tax, tax avoidance experts are vast. With LVT all landowners would be required to register their land and to pay for LVT. Failure to do so would result in the land with no registered owner, being auctioned off to the benefit of the government, which would then most likely use the funds in developing the country.